The financialization of the Spanish economy: debt, crisis and social cuts

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Financialization and growth models

The concept of financialization is used to refer to the increasing power of financial capital since the 1980s. Although this concept refers to mechanisms as old as capitalism, the neoliberal policies of the last decades have led to unprecedented weight of markets, institutions and financial motives in the world economy.

The process of financialization has significantly influenced the growth patterns in developed economies during recent decades, explaining the fragile rate of investment, high levels of unemployment, external imbalances or increase inequalities in the distribution of income. However, the particular form that has adopted in each country the process of financial deregulation, patterns of trade specialization, credit expansion or wage restraint has resulted in different "varieties of financialisation".

On one hand, some economies have presented strong capital inflows resulting in relatively high economic growth, huge credit and real estate bubbles and significant current account deficits (U.S., Ireland, Spain, Portugal, Iceland). Other developed countries (Germany, Netherlands, Austria, Japan) experienced an export-led growth model with modest investment, consumption and GDP growth rates, and with trade surplus that have been used to finance credit bubbles of the first group.

The financialization of the Spanish economy

The Spanish economy has also undergone a significant process of financialization in recent decades: the increase in the value of financial assets has been significantly higher than the growth experienced by the fundamentals of productive activity, and the financial share has augmented rapidly. In particular, the keystone of the financialization of the Spanish economy has been the huge credit bubble accumulated since the late 1990s.

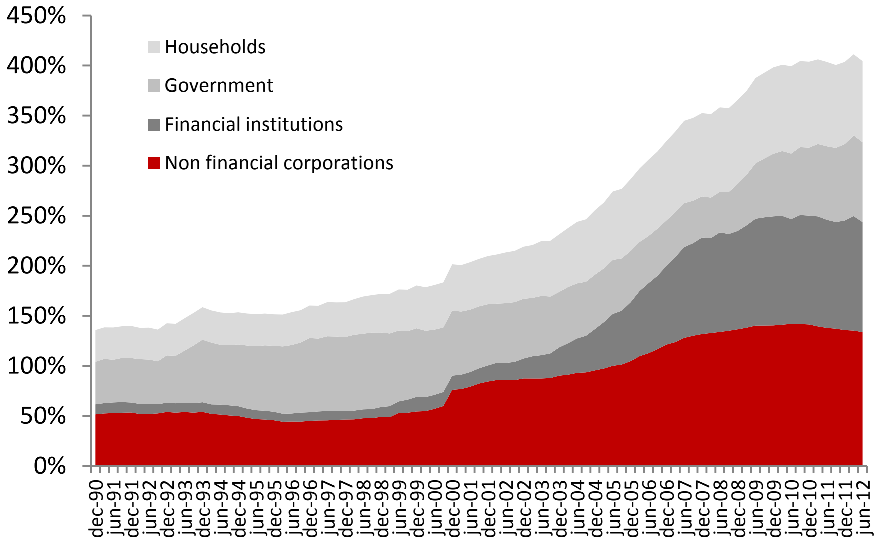
The Spanish economic model was highlighted during the 1996-2007 period by many economists as a "successful" case: economic growth was above the European average, the rate of job creation was very significant, inflation was controlled and all this was consistent with fiscal surpluses.

However, the main weakness of this growth model (shaped by financial capital) was in its own basis: the global surplus of capital in the financial sphere, along with the liberalization process and low interest rates led during this period to a vast access to credit for Spanish businesses and households. The resulting debt-led growth was therefore linked to an intense dynamic of indebtedness and to the housing bubble.

In addition, the Euro has proven to be fully functional to the logic of financialisation. Its introduction in 2002 shaped the driving forces of the growth model: low real interest rates in the European periphery (as a result of a higher structural inflation), deregulation of financial flows and the absence of exchange risk encouraged intense capital inflows in the Spanish economy. Thus, membership in the single currency has meant an expansion of intra-European trade and financial imbalances.

The Spanish household debt rose from 61% of gross disposable income in 1997 to 139% in 2007, significantly higher than that of major European economies (French, Italian and German household debt was, on average, 85% in 2007). However, households are not the only agents that have oversized liabilities. Non-financial corporations have experienced even greater indebtedness. As we can see in Figure 1, these corporations accumulated in 2009 a significant part of the total debt of the Spanish economy (much of this debt was linked to construction and real estate sector). Furthermore, Spanish financial institutions have mediated between households and corporations on the one hand, and international capital markets, on the other, so they have also achieved high levels of indebtedness.

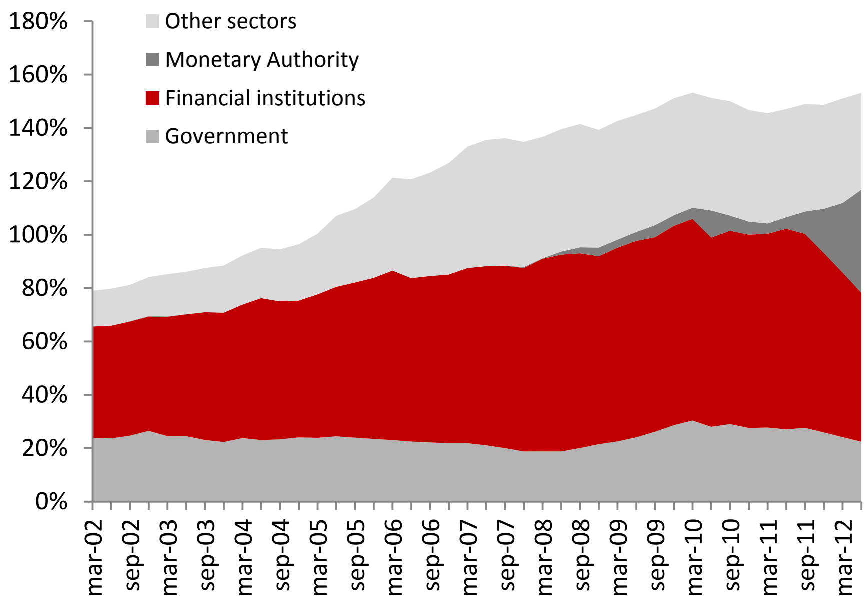
Figure 1: Sectoral composition of Spanish total debt (% GDP), 1990-2012



* We consider debt of institutional sectors in the form of loans and securities other than shares.
Source: Financial Accounts of the Spanish economy, Bank of Spain.

Moreover, as seen in Figure 2, foreign indebtedness of the Spanish economy is very elevated, reaching in 2012 153% of GDP (excluding direct investment). In this figure we can see how the increase of foreign debt the years before the crisis is mainly due to borrowing by financial and nonfinancial companies in international capital markets.

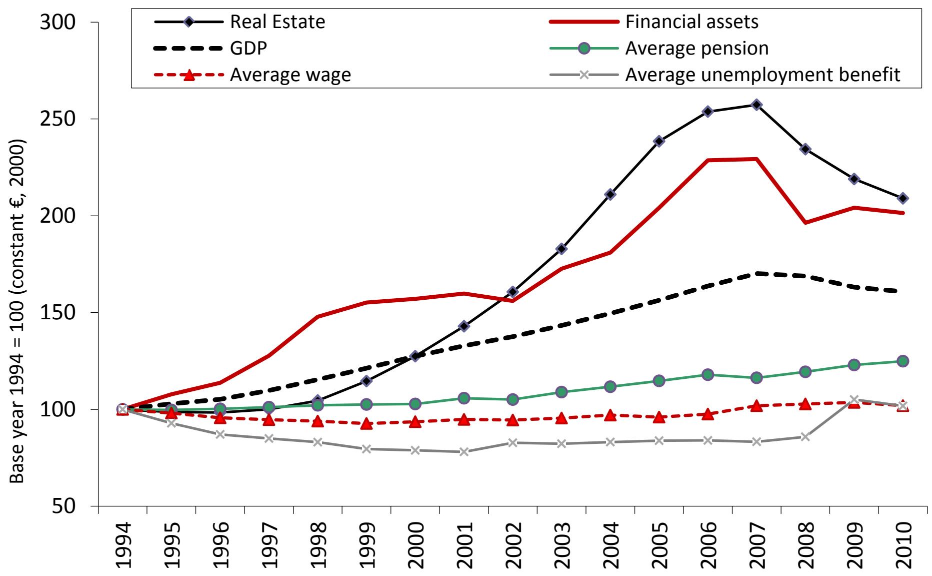
Figure 2: Spanish foreign debt, (% GDP), 2002-2012



* Total debt excluding direct investment.
Source: Financial Accounts of the Spanish economy, Bank of Spain.

The process of financialization of the Spanish economy has contributed to alter the pattern of income distribution. Since this process has channeled capital inflows and savings to real estate and tourism, job growth has taken place in those sectors. However, these sectors create basically temporary, low-skilled and low wage employment. Simultaneously, real estate and financial incomes have experienced unprecedented growth during this period. Thus, the process of financialization has functioned as an income transfer device, against labor and in favor of capital (labor share has decreased in Spain from 60.2% to 52.3% between 1996 and 2012).
As we can see in Figure 3, the growth experienced by the value of financial and real estate assets between 1994 and 2009 were significantly higher than the growth of GDP. In addition, both GDP and financial and real estate assets have grown well above the various components of wage income (real wages, average pension and unemployment benefits). Real wages have remained basically stagnant during this period. We can therefore say that the process of financialization has operated as a lever of social recomposition between classes, making the Spanish model of income distribution even more regressive.

Figure 3: Evolution of wages, unemployment benefits and pensions compared to GDP and components of household wealth, Spain, 1994-2010



Source: Social Barometer of Spain.

Crisis and adjustment policies

The financialization of the Spanish economy has leaded to a growing systemic fragility. The expansion cycle based on credit growth ended when high indebted investors began to sell assets to pay debts. At that point home prices stopped growing, real estate assets were not accepted any longer as collateral to continue to borrow and house bubble collapsed. The balance sheet crisis appeared in Spain: corporations and financial institutions experienced intense asset depreciation while their huge debts remain frozen.

The process of financialization was functional to restoring profitability in recent decades, overcoming the economic crisis of the 1970s. However, this restoration of profitability was possible at the expense of moving forward the contradictions of the accumulation model: deregulation, financial expansion and income transfer have allowed a huge increase of "fictitious assets". These "fictitious assets" represent in fact a claim to property rights or income produced in the real economy, but are devaluated and unconvertible at this moment.

In the first stage of the crisis, during the years 2008 and 2009, measures taken by the Zapatero government focused on important fiscal expenses to sustain employment. However, the second stage of the crisis, which starts in 2010 with the sovereign debt crisis of the European periphery, consolidated fiscal adjustment.

From that moment we see the true orientation of the Zapatero and Rajoy governments: to protect the interests of financial capital (domestic and international) and to ensure the repayment of debts to the extent of socializing the losses of financial institutions.

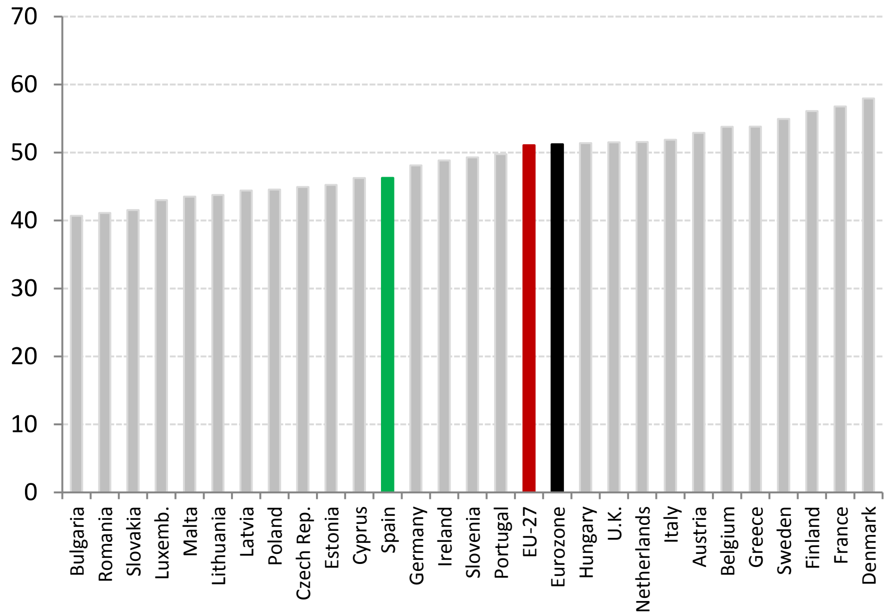
To ensure payment of debts, governments of Zapatero and Rajoy, forced by the EU, have opted for a dramatic fiscal austerity. Between 2010 and 2012 we have seen several pay cuts to public employees (including the elimination of their Christmas extra pay), the labor reform of June 2010 (making possible easier and cheaper dismissals), the pension system reform (increasing the retirement age and reducing the average pension), the deepening of cuts in social expenses (education, health, unemployment benefits…).

The logic of financialization seems further strengthened, since adjustment measures are the priorities of financial capital but not the ones of the social majority.

From private debt to public debt: the bailouts to banks and creditors

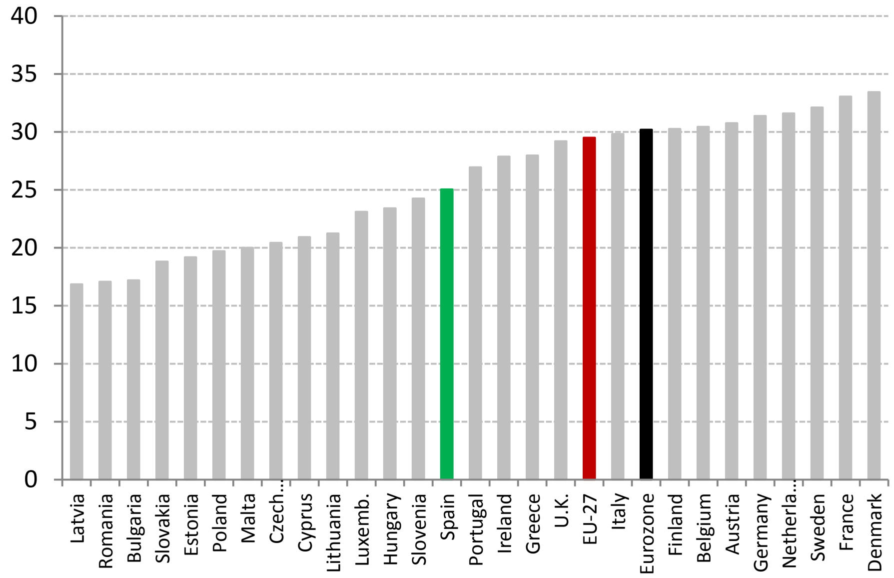
The discourse that seeks to justify the austerity measures is not coherent. There are no data to support the claim that the origin of the current fiscal crisis in Spain is due to a high public spending that must be cut. As shown in Figures 4 and 5, the Spanish public spending is five points below the average expenditure in the euro zone, and social spending is also five points below. Additionally, as can be seen in Figure 6, the Spanish state had balanced public accounts at the time the crisis started: in 2007 Spain had a budget surplus of 1.9% of GDP, in 2009 the surplus had become a deficit of -11.2%, and of -9.4% in 2011. The Spanish government expects a deficit of -7.4% for 2012.

Figure 4: Total public expenditure (% of GDP) EU-27, 2009



Source: Eurostat

Figure 5: Public social expenditure (% of GDP) EU-27, 2009



Source: Eurostat

Figure 6: Government Deficit (-) or surplus (+) (% of GDP) Spain, 2000-2012

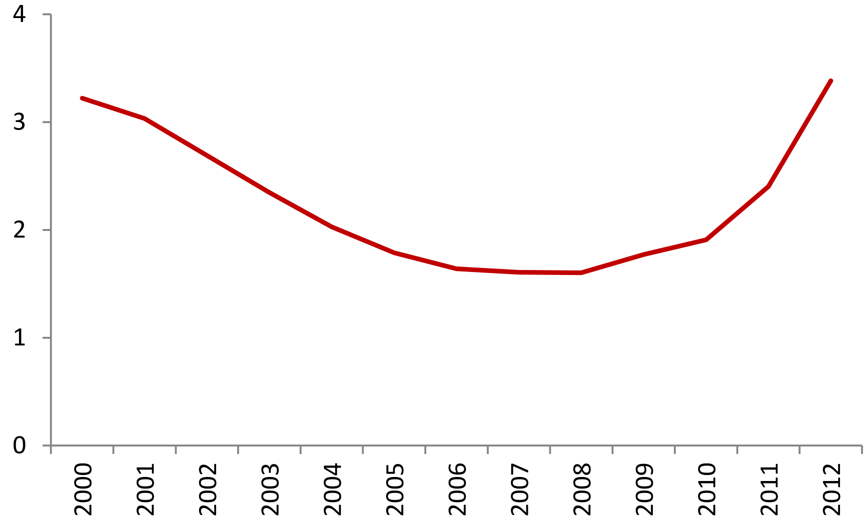
Source: Bank of Spain

The causes of this increase in the public deficit are diverse. On one hand, the sharp drop in tax revenues (personal income tax, VAT and corporation tax) has been decisive. Furthermore, the performance of the automatic stabilizers (including unemployment costs) have led to increased spending (see Figure 9). However, bank bailouts also have conditioned much of government spending during the crisis.

The Bank of Spain acknowledges that problematic exposure of banks and savings banks to the real estate stood at 184,000 million Euros at the end of 2011 (of a total real estate portfolio of 308,000 million). That is, 60% of loans related to real estate

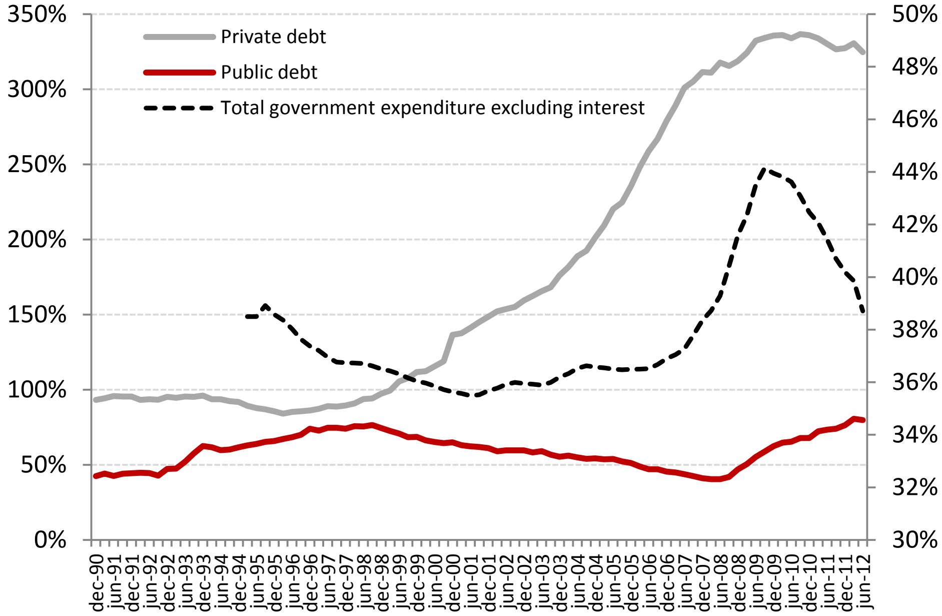
presents the status of "toxic assets" (bad loans, substandard loans and foreclosed assets), a figure equivalent to 17% of Spanish GDP.
To address these problems the government has provided since 2008 aid to Spanish banks worth 160,000 million Euros. This assistance has taken different forms. In 2008 began a plan to buy assets from banks, which provided 19,000 million that have already been returned. That same year the government launched a line of guarantees for banks of 90,000 million. But aids have also taken the form of direct injections: the FROB has injected into the sector over 14,000 million Euros, while the government has recapitalized Bankia with 19,000 million and Catalunya Caixa and Nova Caixa Galicia with another 9,000 million. Finally, bankruptcies of CCM, CAM and UNNIM have been funded with 10,000 million Euros of the Deposit Guarantee Fund. In total, aids to the banking sector, in one form or another, have reached a value equal to 15% of GDP.
The effort to ensure the solvency of Spanish banks (through recapitalizations and bailouts) has determined the fiscal crisis of the Spanish state. Both Zapatero and Rajoy said that aids to banks would not affect taxpayers or the government deficit. However, the Spanish government, given the doubt that the billions injected into troubled banks can be not recovered, increased by 16,600 million the 2011 and 2012 budget deficits. With that, the public debt will rise to 90% of GDP in 2013 (in 2008 was only 37%).
In addition, the State's need to keep going to the capital markets to finance itself has strengthened fiscal crisis: when we analyze the weight of interest paid by the public sector to financial markets (figure 7) we see how there has been a remarkable increase in these payments. To reconcile this increase in financial expenses of the State with the demands required by financial investors, Brussels insists in further deepen public spending cuts (excluding the payment of interest, as reflected in Figure 8). Thus, the General State Budget for 2013 requires cuts worth 40.000 million Euros, while increasing the expenditure on interest payments up to 38,600 million (3.4% of GDP).
Therefore, despite the intense public spending cuts that we have seen since 2010, public debt continues to grow strongly (see Figure 8).

Figure 7: Interest payments on the public debt (% of GDP)
Spain, 2000-2012



Source: Bank of Spain

Figure 8: Public debt, private debt and total government expenditure excluding interest (% of GDP), Spain, 1990-2012



* Liabilities outstanding (Financial Accounts of the Spanish Economy). Private and public debt are reflected on the left axis, and public spending in the right one.
Source: Bank of Spain

The government estimates that it will be necessary to inject another 50,000 million Euros of public money to troubled banks, in line with Oliver Wyman report. Although future injections are made by means of an EU bailout (by the European Financial Stability Facility), the State will guarantee the loan, so injections will be part of the budget deficit if they are considered unrecoverable (highly likely, given what happened with FROB injections in previous years). In this case, Brussels will impose new and additional cuts to offset the deficit increase.
The austerity strategy of the EU to tackle the debt problem of the Spanish economy is actually a bailout for private banks, especially German and French banks. The State guarantees to pay off debt to foreign creditors at the expense of its own resources, thereby increasing public debt and cutting spending.
As we see, the "institutional capture" driven by financial interests over the last decades has led to the Spanish and European public administrations to break into the social battle open at the present time around debt, in order to facilitate the socialization of banking losses.

Against the power of financial capital, what alternative from the left?
One key point for the left in order to build a political alternative to austerity measures is its orientation towards the EU. At this moment, the only favorable exit for the Spanish workers and for the social majority requires a break with the measures imposed by the EU and the Euro discipline.
From the beginning of the crisis, not to go further back, the orientation of Brussels institutions has been clear: the Euro Plus Pact (later the Pact for the Euro) institutionalized fiscal austerity and the priority of debt repayment, promoting for that purpose the liquidation of collective bargaining and wage, public spending and pensions cuts. We must also remember that the Union treaties prohibit European states to borrow from their own central banks, been forced to borrow from private banks at rates and market conditions. This intervention of the EU institutions to serve the interests of financial capital is implemented from decision-making bodies not elected directly by the EU citizens, such as the European Commission, even against the decisions of sovereign parliaments. The requirements imposed by the European Commission, together with the ECB and the IMF as part of the "troika", are therefore hardly compatible with democracy.
The context determining political action and the correlation of social forces is now deeply determined by the economic and institutional dynamics that take place at European level. This is precisely why a left alternative will be doomed to failure if it denies to transcend the national framework to coordinate with other countries' political forces in a common proposal.
Now, how do we begin this break with the EU? What do we offer in return? We must begin to challenge the policies of cuts, i.e. calling to disobey treaties as the Stability and Growth Pact, the Pact for the Euro or the different Memorandum of Understanding. Begin to recuperate fiscal sovereignty involves a necessary break with these agreements.
The social legitimacy gained by those who, in various parts of Europe, oppose to welfare cuts, should be used as a “political fulcrum” to break the logic of austerity imposed by Brussels. Austerity measures (especially in a balance sheet crisis where all the actors try to deleverage simultaneously) sink us into a depressive spiral.
If the barbed wire that Brussels has placed around us forces us to choose between paying the debt or closing hospitals and schools, we will logically have to appeal to

the priorities that a state has with its citizens and start to walk towards debt repudiation. Taking into account that goal (achieve substantial cancellations on public and private debt in the hands of senior creditors), the campaign for debt audit currently underway in various parts of the European periphery can be of great value.

The recovery of fiscal sovereignty to address major public needs requires a comprehensive reform of the tax system to ensure its progressiveness. Tax exemptions of capital income must be reversed, top marginal rates must be raised and tax havens should be banned. A left alternative should try to coordinate such measures at European level with other political forces to strengthen their feasibility.

Nationalized banks should serve as the basis of a public banking system, managed with public interest criteria. Every euro that the state injects into banks should be accompanied by the corresponding access to the capital of the institution. A public good as important as credit should not be left to private banks initiative, with the risk that this entails. Similarly, a strong financial sector regulation it’s needed, as well as capital controls that limit the coercion that financial capital exert on society.

Moreover, in this context of monetary sovereignty transferred to the ECB, this institution should be required to ensure an end to the speculation against sovereign debt of peripheral countries (by purchasing such debt securities and issuing Eurobonds). Obviously this measure will not restore monetary sovereignty to the countries of the Eurozone, will not solve the crisis in these economies, nor resolve the essential problem of the EU institutions (their limited democratic nature). But surely will help alleviate the pressure that financial capital puts on European peripheral states, and thus to stop the offensive against labor and social welfare.

Beyond measures to stop the current offensive of capital, a left alternative should try to coordinate at European level a fight for the employment. To push a reduction in working hours without wage cuts would not only help solve the terrible problem of unemployment, but would also lay the foundations for a new model of income distribution in Europe.

Finally, the break with Brussels policies and institutions here proposed should consider the need for a radical democratic remaking of Europe. Brussels institutions, which do not appear in any Constitution and whose leaders are not elected by any parliament, have completed an unprecedented political expropriation, confiscating the parliamentary sovereignty of European democracies. True, national parliaments have voluntarily allowed that expropriation, but that does not change much the final result. Any government seeking to promote now a truly progressive alternative within the EU will be condemned to violate existing treaties and to clash with the ECB and the European Commission. The democratization of these institutions seems now a true chimera. However, a left alternative cannot give up to the making of a proposal to coordinate policy on the continent. The ruins of the old European Union should serve as a support to build, this time, a truly democratic integration experience.